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IN THE

Supreme Court of the United States

October Term, 1976

No. 76-1281

CHURCHILL FOREST INDUSTRIES (MANITOBA) LTD., CHURCHILL PULP MILL LTD., TECHNOPULP INCORPORATED, STEPHEN E. MOCHARY, JAMES M. BROWN, JR., CHESTER CHASTEK, RIVER SAWMILLS COMPANY and BLUE CONSTRUCTION CORPORATION,
Petitioners,

against

SECURITIES AND EXCHANGE COMMISSION,
Respondent.

PETITIONERS' REPLY MEMORANDUM

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PETITIONERS' REPLY MEMORANDUM

Respondent Securities and Exchange Commission ("SEC") does not dispute the importance of the issue presented by this petition—the extraterritorial scope of the federal securities law—and implicitly contends that it is an issue not yet decided by this Court (SEC Br. p. 12).* This position taken by the SEC is, by itself, sufficient to warrant granting certiorari.

Virtually ignoring the need for this Court to decide this important issue, the SEC argues that certiorari should be

* The following citations are used herein: SEC's Brief in Opposition to the Petition—"SEC Br."; our Petition—"Pet."; Appendix to our Petition—"A"; Appendix in the Court of Appeals—"C.A. App."

denied on the ground that (A) the Third Circuit's decision here is not in conflict with the decisions of other circuits or (B) of this Court, and (C) the issue is not ripe for decision in this case. The SEC's assertions are erroneous.

A. Conflict Among the Circuits

The SEC significantly neglects to offer any meaningful factual analysis to support its conclusory assertion that "there is no conflict between the present case and other appellate decisions" cited in our Petition (SEC Br. p. 11).

Indeed, scrutiny of the one case, the facts of which were specifically mentioned by the SEC, *Bersch* v. *Drexel Firestone, Inc.*, 519 F.2d 974 (2d Cir.), *cert. denied sub nom. Bersch* v. *Arthur Andersen & Co.*, 423 U.S. 1018 (1975), demonstrates the error in the SEC's conclusory assertion. According to the SEC, that decision—in which the Second Circuit held that no securities acts jurisidiction existed over sales to foreigners abroad—is consistent with the contrary holding by the Third Circuit here because in *Bersch* "no fraudulent acts were committed within the United States" (SEC Br. p. 11 n.9).* This contention is the

* It is interesting to juxtapose this assertion with the statement only 3 pages before that *Bersch* stands for the proposition that the "federal securities laws proscribe fraudulent conduct that occurs within the United States, even though the victim is a foreign investor located in another country and there is no impact on investors within the United States." The SEC is in error on both statements. We show *infra* pp. 3-4, that the same domestic conduct, claimed to be fraudulent here, occurred in *Bersch*. And page 985 of the *Bersch* opinion, which the SEC cites for this alleged no-impact-needed holding, relates only to the jurisdictional *power* of Congress to which the *Bersch* court referred immediately before it turned to the question whether, by enacting the securities laws, Congress "mean[t] to go to the full extent permitted" or intended to "leave the problem to foreign countries." 519 F.2d at 985.

linch-pin of the SEC's position of no conflict: unless the domestic conduct in *Bersch* were materially different from the domestic conduct alleged here, the two contrary decisions must be held to be in conflict. Comparison of the facts and holding of *Bersch* and of the Third Circuit decision here demonstrates the substantial identity of the facts and, therefore, the conflict in the holding.*

Following, we set out in tabular form the United States activities in the instant case as enumerated by the Third Circuit (A4), alongside of which we set out the United States activities in *Bersch* as enumerated by the Second Circuit in its opinion:

Alleged United States Activities

In This Case	In *Bersch*
Various negotiations in U.S.	Meetings in New York on numerous occasions "to initiate, organize, and structure" the allegedly fraudulent transaction and meetings with underwriter in U.S. (519 F.2d at 985 n.24)

* While we hereinafter show in the text that *Bersch* and the instant decision are in conflict, reference must be made to one material fact overlooked by the SEC: the Second Circuit in *Bersch* itself admitted that it, and its companion decision in *IIT* v. *Vencap, Ltd.*, 519 F.2d 1001 (2d Cir. 1975), went "beyond prior decisions" in extending the securities laws to transnational transactions (*IIT*, 519 F.2d at 1018; see also *Bersch*, 519 F.2d at 987), since prior decisions required proof of impact on domestic investors or securities markets in order to sustain jurisdiction (*Bersch*, 519 F.2d at 987 n.29). Hence, assuming *arguendo* that the Third Circuit's decision here were consistent with *Bersch*, the conflict between them and prior decisions (including those of other circuits) would warrant a determination by this Court of this important issue.

In This Case	In *Bersch*
Execution of one contract in New York	Mailing by defendants of offer (prospectus containing false representations) to some persons in U.S. who accepted offer by executing subscription in, and mailing from, U.S. (*id.* at 991)
Use of instrumentalities of interstate commerce (*e.g.*, telephones and mails)	Use of instrumentalities of interstate commerce, *i.e.*, telephone (*id.* at 985 n.24), and mails (*id.* at 990)
Incorporation of companies or establishment of corporate offices in U.S.	Defendants included U.S. corporations with principal offices in U.S. and/or subsidiaries with U.S. offices (519 F.2d at 979 and n.9)*
Use of N.Y. office of a Swiss bank for proceeds	"Accounts for the proceeds . . . were opened" in a N.Y. bank (*id.* at 985 n.24)
Maintenance of books and records in U.S.	N.Y. law firm and N.Y. accountants were retained (*ibid.*), with at least relevant work papers maintained in U.S. (see 389 F. Supp. at 456)
Drafting of agreements in U.S.	Drafting of parts of the relevant documents was done in U.S. (519 F.2d at 985 n. 24)
Transmittal of proceeds to and from U.S.	"the proceeds were to be deposited" in N.Y. bank "pending remittance" abroad (*ibid.*)

* The individuals responsible for the alleged wrongdoing in *Bersch*, *i.e.*, the President, chief operating officers, and many of the employees of I.O.S., were American citizens (389 F. Supp. at 455 n.8).

Despite these basically similar activities in the United States in both cases, the decisions by the Second Circuit and the Third Circuit were in conflict: the Second Circuit in *Bersch* held that no subject matter jurisdiction existed insofar as the sales were to foreigners outside the United States, while the Third Circuit here held that subject matter jurisdiction existed over the sales abroad to a single foreign entity.

The reason for these conflicting results appears in each court's statement of its understanding of the controlling legal principles. The Second Circuit in *Bersch* stated the law was as follows: federal jurisdiction does *not* exist over

> "sales of securities to foreigners outside the United States *unless* acts . . . within the United States *directly caused* such losses." (519 F.2d at 993; emphasis added)

The Third Circuit, on the other hand, stated the law was as follows:

> "[F]ederal securities laws do *grant jurisdiction* in transnational securities cases where *at least some activity* designed to further a fraudulent scheme occurs within this country." (A9)

It is true that, after enumerating this "some activity" test, the Third Circuit used the adjectives "substantial" and "essential" to describe the conduct in the United States (A12). Use of these words does not alter the very extreme extent of extraterritorial jurisdiction of the securities laws prescribed by the decision. The SEC's attempt (SEC Br. pp. 7, 8) to reconcile the Third Circuit's decision here with that of the Second Circuit in *Bersch* by reference to these adjectives is meritless on several other grounds as well.

First, the SEC's reliance on the various adjectives used by the Third Circuit here to describe the alleged domestic conduct ignores the simple fact, demonstrated above, that, on substantially identical conduct within the United States, the Second Circuit held that no jurisidiction existed on sales to foreigners abroad while the Third Circuit held to the contrary.

Secondly, the explanative language in the Third Circuit's decision here demonstrates its conflict with the *Bersch* requirement that the U.S. conduct must have "directly caused" the loss to the foreigners abroad. We quoted in our Petition, as we do here on page 5 *supra,* the portion of the opinion below which demonstrates the holding to be that "some activity" in the United States in furtherance of the fraud is all that is needed for jurisdiction to attach.*

The SEC now argues that the Court below did not mean "some activity"—the words used in the opinion—but actually meant "some substantial activity." No basis exists for the SEC thus to revise the opinion filed by the Third Circuit. And, in fact, other portions of the opinion below demonstrate that use of the phrase "some activity," without the adjective "substantial," was intentional. For ex-

* The SEC (SEC Br. p. 8) incredibly objects to our use of the word "any" in our Petition (p. 2) as a synonym for the word "some" used by the Third Circuit in its opinion. Webster's New International Dictionary (2d ed. 1959) lists the word "some" as the single synonym for the word "any" (p. 121). The first definition of the word "some" is "a certain; one" (p. 2396). Finally, the dictionary explains the synonyms "some" and "any" in the following manner: "some emphasizes lack of specification, any stresses indifference of choice or lack of limitation" (p. 2397). Given these dictionary references, our use of the word "any" as a synonym for "some" was clearly appropriate in the context of this case.

ample, the Third Circuit cited and relied on its prior decision in *Straub* v. *Vaisman & Co.,* 540 F.2d 591 (3d Cir. 1976) as "flatly proclaim[ing]" the rule that "conduct in this country, standing alone, is enough for jurisdiction to attach under the federal securities laws" (A7).*

Finally, the Second Circuit in *Bersch* held that substantial conduct in the United States—*i.e.,* acts "of material importance . . . [which] have significantly contributed to" the violation—are sufficient for jurisdiction where the defrauded party was an American abroad, but are *insufficient* to create jurisdiction where the defrauded party was—as here—a foreigner abroad (519 F.2d at 993).**

Likewise, the SEC's reliance on the Third Circuit's reference to the conduct here as "essential" to the fraud (SEC Br. pp. 7-8) does not vitiate the conflict with *Bersch* since, as shown above, the domestic conduct in both cases

* The *Straub* decision, relied on by the Third Circuit below and by the SEC here, is clearly inapposite on the facts. *Straub* did not involve a predominantly foreign transaction, since the defendant was "an American securities broker," registered with the SEC, charged with fraud in the sale of "stock in an American corporation traded on American over-the-counter exchange"—clear proof of domestic impact (540 F.2d at 595). Significantly, the language quoted in the text above was used to describe the extent of jurisdictional power which Congress is free to exercise, not to describe the jurisdiction intended to be exercised by Congress. The Third Circuit here converted the *Straub* description of the extent of jurisdictional power available to Congress into a statement of the scope of jurisdiction actually invoked by Congress.

** The SEC's reliance on the Third Circuit's use of the adjective "substantial" in fact furnishes another reason for this Court to entertain this Petition. The Second Circuit in *Bersch* used phrases "material importance," "significantly contribut[ing]," and "directly caus[ing]" to describe the different tests for jurisdiction (519 F.2d at 993). To the extent the Third Circuit's use of the adjective "substantial" is given any importance, it indicates the Third Circuit's rejection of all three of the *Bersch* phrases in favor of the "substantial" adjective. Can it be said that such individual choice of descriptive adjectives by different circuits furnishes any precedental value?

was substantially the same. Moreover, the Second Circuit in *Bersch* also suggested that the domestic conduct there was essential to the consummation of the fraud, in the "but for" sense (519 F.2d at 992). In addition to its use of the "but for" phrase, the Second Circuit explained that the domestic conduct there "helped to make the gun whence the bullet was fired from places abroad; alternatively proper action in the United States would have prevented the gun's ever being sent abroad" (519 F.2d at 987)—*i.e.,* but for the acts in the United States the fraud would not have occurred abroad. Yet such conduct was held in *Bersch* to be insufficient for securities act jurisdiction over sales to foreigners abroad.

The SEC seeks to ignore the remaining decisions by other circuits on the ground that subject matter jurisdiction was upheld in those cases, albeit "in some of these cases . . . on grounds other than in this case" (SEC Br. p. 12). But it is no less a conflict among the circuits, warranting this Court's determinative clarification, that the conflicting rules for determining subject matter jurisdiction were set out by different circuits in decisions upholding jurisdiction rather than in decisions denying jurisdiction.

In a final attempt to avoid the conflict that exists among the circuits, the SEC contends that this case is distinguishable on the ground that the plaintiff here is the SEC, while, with the exception of *Securities and Exchange Commission* v. *United Financial Group, Inc.,* 474 F.2d 354 (9th Cir. 1973), all of the other cases were commenced by private plaintiffs. For this proposition, the SEC relies on the rule that consummation or success of a fraud is not a prerequisite to jurisdiction in an injunctive action brought by

it, as opposed to an action brought by a private plaintiff.* But the SEC thereby merely raises a straw man. Of course, where an attempt is a crime or civilly actionable, jurisdiction would exist over such attempt to commit a fraud *if* jurisdiction would have existed over the intended fraud. *United States* v. *Berrigan,* 482 F.2d 171, 190 (3d Cir. 1973) ("Simply stated, attempting to do that which is not a crime is not attempting to commit a crime"); and see *Coleman Motor Co.* v. *Chrysler Corp.,* 525 F.2d 1338, 1349 (3d Cir. 1975). The determination on the question of jurisdiction over an attempted securities fraud depends on whether the intended fraud involved "domestic conditions"**—the same test as applicable to a consummated fraud; for Congress clearly could not be said to have intended to assert jurisdiction over an attempted (but unconsummated) fraud where it did not intend to assert jurisdiction over the same facts if successful.

Moreover, it is difficult to conceive of a rational basis for a holding that a statute grants subject matter jurisdiction over a set of facts if the SEC brings the action, but the same statute fails to grant subject matter jurisdiction over the identical set of facts, if brought by the alleged victim. Whether any specific plaintiff may bring an action raises questions of standing [*Landy* v. *Federal Deposit Ins. Corp.,* 486 F.2d 139, 156 (3d Cir. 1973), *cert. denied,* 416 U.S. 960 (1974)], which only can arise *if* subject matter jurisdiction is first found to exist.

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* The SEC, in suggesting this distinction, exalts form over substance, since the SEC is, in reality, acting as the alter ego for the allegedly defrauded foreign governmental entity in seeking disgorgement and an accounting of all monies received by specified defendants (C.A. App. 179-80).

** *Foley Bros. Inc.* v. *Filardo,* 336 U.S. 281, 285 (1949).

B. Conflict With Decisions of This Court

Although we cited (Pet. pp. 18-22) eight decisions of this Court on the issue of extraterritorial jurisdiction as suggesting a conflict between the reasoning of those decisions and the Third Circuit's decision here, the SEC has significantly attempted to distinguish only three of them.

The SEC's attempted distinction of *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 506 (1974), is merely a restatement of what we noted in our Petition (p. 18n)—that the motion to dismiss for lack of subject matter jurisdiction, having been denied by the district court, was not appealable and thus not before this Court. But that procedural technicality does not detract from the conclusion, discussed in our Petition (pp. 18-19)—that this Court's rejection of the rule of *Wilko* v. *Swan*, 346 U.S. 427 (1953), against staying securities act lawsuits in favor of an arbitration, required this Court's implicit decision that the securities laws do not apply to an essentially foreign transaction (albeit with some domestic conduct), such as was involved in *Scherk* and is involved here.

The SEC's argument (SEC Br. p. 12) that this Court's refusal to find federal jurisdiction in *Benz* v. *Compania Naviera Hidalgo, S.A.*, 353 U.S. 138 (1957), and *McCulloch* v. *Sociedad Nacional de Marineros de Honduras*, 372 U.S. 10 (1963), is consistent with the Third Circuit's finding federal jurisdiction here does not withstand analysis. This Court denied jurisdiction in those two decisions because of the absence of any domestic impact, *inter alia*, to avoid "international discord" and "retaliatory action from other nations" (SEC Br. p. 12). The SEC, in its endeavor to

extend its jurisdiction, argues that such discord and retaliatory action are "likely . . . to result from a denial of jurisdiction" here (SEC Br. p. 12). But such decision, extending the SEC's jurisdiction to essentially foreign transactions without any domestic impact, is one that must be made by Congress, not the SEC, as this Court clearly stated in *Benz*:

> "For us to run interference in such a delicate field of international relations there must be present the affirmative intention of the Congress clearly expressed. It alone has the facilities necessary to make fairly such an important policy decision where the possibilities of international discord are so evident and retaliative action so certain. We, therefore, conclude that any such appeal should be directed to the Congress rather than the courts." 353 U.S. at 147

Indeed, the SEC's contention for extension of federal securities act jurisdiction, in order to avoid international discord, furnishes another example of the conflict on this subject requiring the grant of the Petition here. As the quotation by the Second Circuit in *Bersch*, 519 F.2d at 996, from *Investment Properties Int'l Ltd.* v. *I.O.S., Ltd.* [1970-71] CCH Fed. Sec. L. Rep. ¶93,011, at p. 90,735 (S.D.N.Y. 1971) (Frankel, J.), *aff'd on expedited appeal without opinion* (Docket No. 71-593, 2d Cir. 1972) (quoted at p. 10 of our Petition), demonstrates, other respected federal courts expressed the diametrically opposite view that such international discord would occur from thus extending securities act jurisdiction.*

* An example of the international discord that could be created by the Third Circuit's extension of securities law jurisdiction is found in the *Bersch* facts where J. H. Crang & Co., a Canadian broker, was being sued for fraud under our securities laws in connection with a prospectus "conforming to the laws of Canada and its provinces" (519 F.2d at 980).

C. Ripeness for Decision

The SEC (SEC Br. p. 8), seeking to avoid review by this Court, suggests that this proceeding is at a "preliminary stage" and that, therefore, review should await a trial and an appeal on the merits. Such delay (i) is inconsistent with the purpose of Rule 12(b), F.R.C.P., (ii) is unwarranted here since an issue of law, not fact, is involved, and (iii) would impose on petitioners an enormous monetary and time burden of litigating through trial and appeal to obtain a determination on this initial question of the court's jurisdiction to hear the case.

A Rule 12(b)(1) motion, as involved here, presents "preliminary matters that normally should be adjudicated early in the action." 5 Wright & Miller, *Federal Practice and Procedure* §1349, p. 539 (1969). The "rationale underlying" such motion is that it is "likely to produce an overall saving in time and avoidance of delay, thereby benefitting both the parties and the courts." *Ibid.* To refuse to decide this issue because it is in a preliminary stage would thus run counter to the purpose of the rule, *i.e.*, to decide such preliminary matter at this early stage. The reasons which induced the Second Circuit to allow an immediate appeal, pursuant to 28 U.S.C. §1292(b), on the motion to dismiss for lack of subject matter jurisdiction in *Bersch*, likewise mandate this Court's grant of certiorari here: "the question of subject matter jurisdiction is a controlling issue of law" (519 F.2d at 994 n.44a); "there is substantial ground for difference of opinion" on the issue (*ibid.*; see also *id.* at 993); and an "immediate appeal . . . will materially advance the ultimate determination . . . and 'would save . . . the cost and delay of protracted and expensive litigation' " (*id.* at 994 n.44a).

Moreover, the *legal* issue presented by this Petition will not be altered by any fact finding. The SEC concedes that the alleged fraud was against a single foreign governmental entity (SEC Br. p. 3), without any impact on American investors or American securities markets (SEC Br. p. 8), and that the consummation of the alleged fraud—the purchase of and payment for the securities—took place in Canada (SEC Br. pp. 7, 9) with the proceeds to be used for a forestry complex in Canada (SEC Br. p. 5). Petitioners, for purpose of this motion, concede the domestic conduct alleged in the complaint. The legal question thus presented needs no fact finding: does securities law jurisdiction exist over a fraud, consummated abroad, against a foreign governmental entity, involving an industrial development abroad, and without any domestic impact, merely because some conduct, in furtherance of that fraud, occurred in the United States?*

If this Court's answer to that legal question is in the negative, petitioners are entitled to obtain that decision at

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* The SEC states that review should await a trial since the complaint might be dismissed for want of jurisdiction after trial if "it is established that no fraudulent conduct occurred within this country, or such conduct was so *minimal* as to be immaterial" (SEC Br. p. 8; emphasis added). This statement too demonstrates that it is a legal issue, not a factual issue, that is involved here and thus ripe for determination. It is difficult to reconcile this suggestion, that conduct within the United States, as long as it is more than minimal, is sufficient to create securities act jurisdiction, with even the *Bersch* holding; for *Bersch* held that "significant" conduct in this country —clearly greater than more-than-minimal—while sufficient to create jurisdiction over sales to Americans abroad, was insufficient to create jurisdiction over sales to foreigners abroad—the factual context here. Indeed, the Third Circuit's use of this more-than-minimal language at the end of its opinion (A14) to summarize its holding demonstrates the extreme to which that court has sought to push the extraterritorial jurisdiction of the securities acts. The legal issue of whether any more-than-minimal conduct in the United States is sufficient for securities act jurisdiction need not, and should not, await a trial; it can be decided at this time.

this stage, rather than be required (a) to endure the lengthy pre-trial proceedings and trial which are endemic to this type of complaint, or (b) capitulate to the infinite litigative resources of the SEC in order to avoid the financial drain of such discovery and trial. Either alternative is inequitable and unnecessary since the determination of subject matter jurisdiction can properly and should be made by this Court at this time.

Conclusion

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

(See Counsel to Brief on Facing page ☞)

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